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THE GENERAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENTS ATTRACTION IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

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Abstract: *In the context of globalization, FDI is the engine of economic development and a unique way for connecting to the free market economic system, the creation of effective promotion policies proving to be useful amid increased competition. The purpose of this paper is to present national policies on foreign direct investment regime in Central and Eastern Europe, with a special interest for Romania, Bulgaria, Hungary and Slovenia, focusing on several fundamental issues: (1) What are the mechanisms and instruments used to support a policy around FDI? (2) What are the rationales for a policy that is promoted to attract foreign direct investment? (3) What is the impact on FDI?*

Keywords: *foreign direct investments, active and passive policies, privatization, tax incentives, promotion agencies, guarantees*

JEL Codes: *F21, F30, H20, C21*

1. INTRODUCTION

Foreign direct investment (FDI) constitute currently one of the most dynamic component of international economic flows, through the fact that they affect and change the essence level of international economic integration, links to production processes, as well as competitiveness relationships between firms and national economies. Given that in the contemporary global economy, both trade and production of goods and services experienced a significant process of globalization, foreign investment's use to fund and implement national economic policies has become widespread.

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The way in which FDI benefits can be used, the degree of involvement in the receiving economy, essentially depends on the policies pursued. As part of the "locations" source, **the types of policies** aimed at attracting foreign direct investment define two broad categories, namely passive and active. The difference between them is that passive policies are limited to creating an attractive business environment, while active policies aim at the use of specific tools and levers to achieve a harmonization of investors' interests with overall development objectives of the host country.

Viewed in an analytical manner, the measures associated with *passive policies* are meant to create a friendly, attractive environment to foreign investors, without offering particular advantages. In this regard, a number of *safeguards* (related to the free movement of capital, the existence of a competitive environment, the free movement of goods, etc.) are provided to encourage investors to locate projects on a certain territory. *Involvement of foreign investors in privatization of state's assets* is another passive tool to promote foreign direct investment, meaning that the privatization process is able to entail a range of opportunities for acquisitions in favour of foreign investors.

The best way to attract FDI and multiply their benefits is not always passive liberalization. Attracting foreign investment in a highly competitive market requires major location advantages and more targeted promotional efforts. In this direction work ***active policies***, in which overall FDI promotion is done by providing incentives and through the activities of agencies established for that purpose.

The purpose for providing *incentives* is to ensure increased profitability of foreign direct investment, and reduce uncertainty and risk (associated with information asymmetry) to which foreign investors are exposed. The most common are *tax incentives* aimed at reducing the overall tax burden on foreign investors and occur widely, through exemption from taxation of benefits, turnover, value added tax on imports or exports, etc. Another category of *incentives*, namely *financial incentives*, that act as direct grants, preferential loans, public capital participation, insurance at preferential rates, etc., have developed fast in the recent years, particularly in developed countries (EU and U.S.A). In practice, with active policies there may also be associated *other incentives* as well, in general, all economic measures meant to increase revenues and return on investment through non-financial means such as grants for infrastructure access, subsidized services mediated by investment promotion agencies, advantages in terms of market access, etc..

FDI promoting agencies' work, associated with active policies aim at promoting foreign investment in a given territory in order to create jobs and stimulate economic development in general. This basic objective may as well be extended in other directions, such as accelerating the transition to a market economy, promoting technology and know-how transfer, industrial revitalization, strengthening the local supply, environmental protection activities by capturing unpolluted activities.

It is important to note, however, that beyond all these types of incentives, which take various forms, the most important incentive for a foreign investor is the existence of dynamic economies, where local entrepreneurs are able to flourish and diversify their businesses. Basically, a foreign investor may not be placed under a glass bowl, isolated from the rest of that economy. Therefore, no matter how many incentives would a country in recession give to foreign investors, they will not come if local entrepreneurs, who will be their business partners, are not in good economic shape.

2. SPECIFIC DIMENSIONS OF FDI POLICIES IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

2.1 Guarantees for foreign investors

- ***Guarantees for capital free movement***

Capital account liberalization in the countries of Central and Eastern Europe[2] can be considered as having taken place in a highly accelerated pace since the beginning of transition. The wish of becoming EU members, played a key role in shaping this trend, as long as the regulations provide for the free movement of persons, goods and capital within the European Union. In this respect, acceding countries had to undertake full capital account liberalization until integration, conducted in two phases: the liberalization of medium and long term capital flows in a first stage, and the liberalization of short term capital flows in a second phase.

As the economic freedom index[3] built the Heritage Foundation, the liberalization of capital flows in Romania, Bulgaria, Hungary and Slovenia is not final, is oscillating developments in three of four cases, but this exceeds 50% in all cases (Figure 18).

Hungary seems to be, in the last decade, the only country to maintain the liberalization of investment at a constant level (70%) level which is interpreted through a policy of encouraging foreign investment, neutral treatment, the existence of a foreign investments code characterized by simplicity and transparency, as well as an efficient bureaucracy. However, there are still kept a number of restrictions on foreign investment in certain sectors such as utilities or national security. With a more oscillating trend, ***Slovenia*** has achieved today, like Hungary, the threshold of 70%, which makes clear the action to remove restrictions on free movement of capital, especially after the moment of EU integration in 2004.

[2] The country sample comprise of Romania, Hungary, Bulgaria and Slovenia.

[3] The index is represented by the simple average of 10 individual liberties, appreciated on a scale from 0 to 100, where 100 represents absolute freedom.

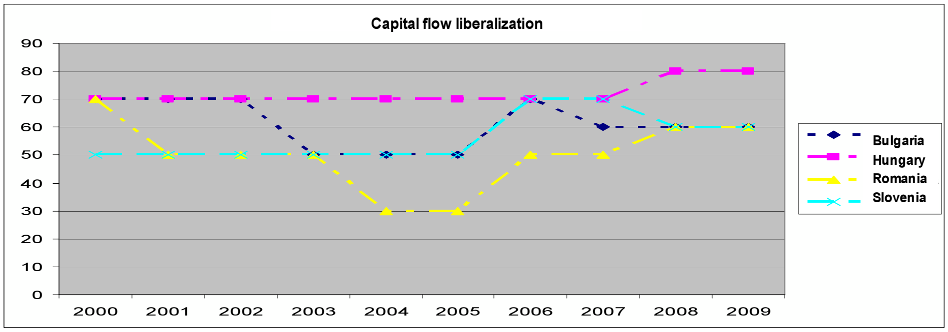

Figure 18 *Liberalization of capital flows in Romania, Bulgaria, Hungary, Slovenia*
Source: Heritage Foundation, Index of Economic Freedom, 2000-2009

With a level for the freedom of investment of 60%, ***Bulgaria*** does not guarantee the application of the bureaucratic treatment, law opacity and restrictions on capital transfers. As regards ***Romania***, the dynamics of the index on freedom of investment is at least unexpected, figures showing an increase, after the year 2000, of restrictions on the free movement of capital. However, in 2009, it stands at 60%, which means that there are still some restrictions on land acquisition, there are bureaucratic impediments, corruption, partially restricted access to exchange, international payments and capital transfer.

- ***Ensuring a normal competitive environment***

Legislative framework on competition policy in East European countries mainly follows lines drawn by European Union legislation, trying to protect, maintain and stimulate competition and a normal competitive environment. Such a framework promotes the interests of consumers and creates conditions for economic evaluation based on uniform principles, while its provisions must be followed by all foreign companies that invest or acquire other companies.

A major coordinate of a normal competitive environment is given by the absence of price controls; there is a consensus among economists that market efficiency is undermined by price controls. This element is shown together with the inflation rate in the construction of the "Monetary Freedom" index, performed by the same Heritage Foundation. For the sample of countries considered, there can be observed a convergence to a degree of liberalization of about 80%, with Romania and Bulgaria seeing more regulation failure (Figure 19).

- ***Ensuring market access for investment projects***

This aims to guarantee foreign investors the opportunity to enter the markets of Central and Eastern European countries by setting up entities that can take various forms, in accordance with the regulations of each host country. In ***general***, at the immediate reach of foreign investors are the following legal forms starting a company: companies with limited liability, joint stock companies, joint companies, limited or unlimited partnerships, branches of foreign companies, these options enabling a wide range of activities. Of these, limited liability companies are preferred, due to the greater flexibility and simplified procedures, while joint stock companies are more strictly regulated meant for big business, with many investors.

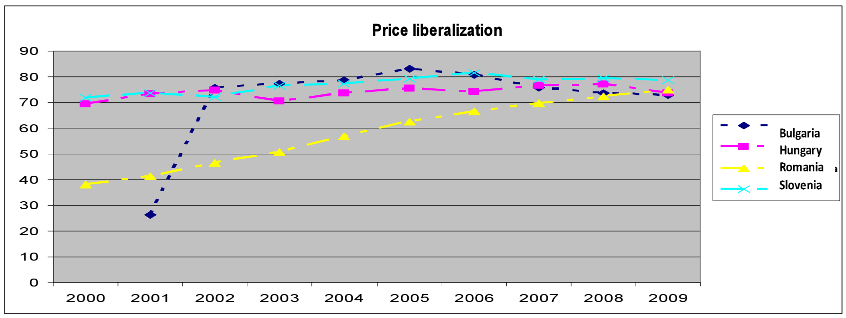

Figure 19 *Price liberalization*
Source: Heritage Foundation, Index of Economic Freedom, 2000-2009

The freedom in the conduct of businesses is captured through one suggestive indicator underlying the economic freedom index developed by the Heritage Foundation. "Business freedom" is a quantitative measure of the ability to initiate, conduct and liquidate a business. On a scale of 0-100, 100 designates a truly open business environment[4]. With a much higher degree of freedom in the conduct of business during the transition, Slovenia and Hungary are caught from in the last period by Romania and Bulgaria. So today, all four countries are characterized by an open business environment in almost 80% (Figure 20).

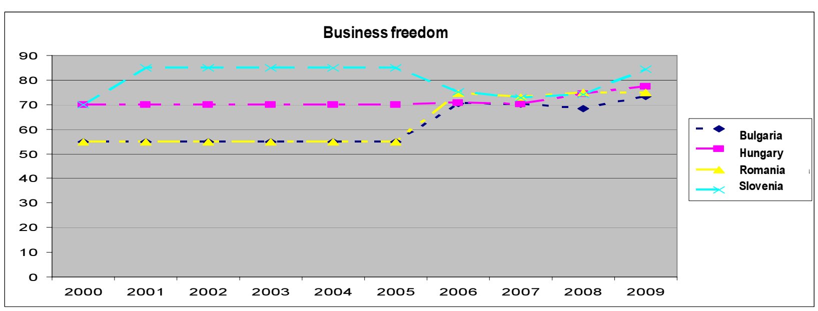

Figure 20 *Business freedom*
Source: Heritage Foundation, Index of economic Freedom, 2000-2009

[4] The following elements concur in an equal proportion to the construction of the indicator: number of procedures, number of days to conduct a procedure, cost and minimum capital necessary to launch a business or obtain a license, and the time, cost and rate of return on business liquidation.

- ***Free movement of goods guarantees***

The liberalization of commercial transactions carried out by Romania with the exterior began in 1990 and has gradually evolved, being now in line with EU directives and international treaties to which Romania is party. The guarantee of the right to conduct foreign trade operations for any company was further completed by progressively eliminating excessive requirements for approval and raising customs duties. Romania Association Agreement with the European Union, which came into force in 1995, had an important contribution to further trade liberalization[5].

Although aligned with the World Trade Organization requirements on liberal regime for foreign trade, and despite a customs procedure based on the EU Customs Code, ***Bulgaria's*** external transactions are subject to administrative control more pronounced than that observed in Romania. Thus, a special permit entitles the trading of certain goods such as radioactive substances, nuclear materials and explosives, pharmaceuticals, military products, etc. Moreover, there are banned the exports of goods like products from burned wood, and transactions involving substances that endanger the environment.

In this matter as well, Hungary recorded a better position, generally speaking, Foreign Investment Law adopted in 1988, guaranteeing full protection and security for business conducted by non-resident investors (including foreign trade operations)

As indicated by the extent of trade liberalization formulated by the Heritage Foundation, which takes into account both tariff barriers and non-tariff barriers, as the developments are more or less oscillating, the degree of trade liberalization in the four countries approached each other, hovering between 80% -90% (Figure 21).

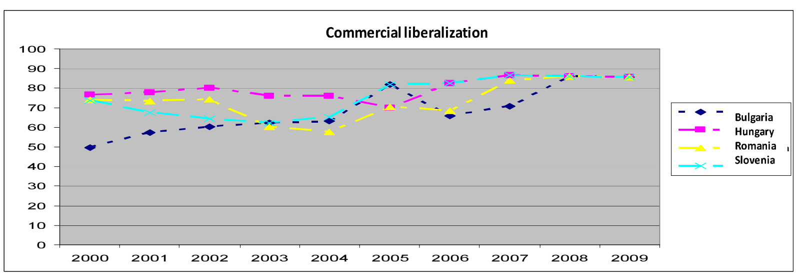

Figure 21 *The extent of liberalization in Bulgaria, Hungary, Romania and Slovenia*
Source: Heritage Foundation, Index of Economic Freedom, 2000-2009

[5] An important contribution to this process has had the entrance of Romania as part of a series of agreements such as CEFTA (Central European Free Trade Agreement - 1997), WTO (World Trade Organization - 1999), Global Trade Preferential System (1989) General System of Preferences (preferential treatment by some countries like USA, Canada, New Zealand, Japan, Russian Federation, Belarus and Kazakhstan).

To highlight and quantify the links between foreign direct investment flow (F) business freedom (B) commercial freedoms (T), investment freedoms (I) and monetary freedoms (M) at the level of the four countries considered (Bulgaria, Hungary, Romania, Slovenia), in the period 1996-2008 (available data), we have built **a regressive "pool" model**, with fixed effects (at the cross-section and period level), with the following form:

$$F_t = \alpha + \beta_1 x I_t + \beta_2 x B_t + \beta_3 x T_t + \beta_4 x M_t + \varepsilon_{it} \quad (1)$$

Where,

F_t - dependent variable F (source - U.N.C.T.A.D);

α - free term;

β_i - coefficients of the independent variables;

I, B, T, M_t - independent variables (source - Heritage Foundation, *Index of Economic Freedom*);

ε_{it} - random term;

$\overline{1,4}$ - the number of cross sections (four - Bulgaria, Hungary, Romania and Slovenia); t – the period (1996-2008).

Statistical tests' results for modelling liberties' impact in business, commercial freedoms, investment liberties and monetary freedoms on net FDI flows are illustrated in Table 10.

Table 10 *Statistical tests' results regarding the modelling of guarantees' impact on net FDI flows*

Dependent Variable: F?
Method: Pooled EGLS (Cross-section weights)
Total pool (balanced) observations: 52
Linear estimation after one-step weighting matrix
Period weights (PCSE) standard errors & covariance (d.f. corrected)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2677.299	3330.536	-0.803864	0.4274
I?	-40.23860	19.43675	-2.070232	0.0466
B?	185.7441	38.68704	4.801196	0.0000
T?	-109.3234	25.66969	-4.258853	0.0002
M?	59.69742	14.19610	4.205199	0.0002
Fixed Effects (Cross)				
BULGARIA--C	1541.620			
UNGARIA--C	699.7272			

Variable	Coefficient	Std. Error	t-Statistic	Prob.
ROMANIA--C	3208.725			
SLONENIA--C	-5450.072			
Fixed Effects (Period)				
1996--C	-1229.219			
1997--C	-825.0557			
1998--C	-1271.777			
1999--C	-606.6432			
2000--C	-268.2073			
2001--C	-1308.555			
2002--C	-1945.757			
2003--C	-2716.714			
2004--C	-925.9354			
2005--C	889.2030			
2006--C	2227.795			
2007--C	3527.349			
2008--C	4453.517			
	Effects Specification			
Cross-section fixed (dummy variables)				
Period fixed (dummy variables)				
	Weighted Statistics			
R-squared	0.939916	Mean dependent var		3426.740
Adjusted R-squared	0.904240	S.D. dependent var		4024.438
S.E. of regression	1245.364	Sum squared resid		49629830
F-statistic	26.34650	Durbin-Watson stat		1.489664
Prob(F-statistic)	0.000000			
	Unweighted Statistics			
R-squared	0.914769	Mean dependent var		3215.594
Sum squared resid	50691492	Durbin-Watson stat		1.373127

We observe that most statistical tests lead to the conclusion that the model can be successfully used to quantify the relationship between FDI flows (F) and business freedoms (B) commercial freedoms (T), freedom of investment (I) and freedoms

Monetary (M) at the four states considered (Bulgaria, Hungary, Slovenia and Romania), in the period 1996-2008 (available).

In addition, model validation is also given by the fact that most *unit root* tests of residual values shown in Table 11, confirm its stability and representativeness (with one exception, the Hadri Z-stat test).

Table 11 *Unit-root test results for the residual values*

Group unit root test: Summary
Series: RESIDBULGARIA, RESIDUNGARIA, RESIDROMANIA, RESIDSLONENIA
Exogenous variables: Individual effects
Automatic selection of maximum lags
Automatic selection of lags based on SIC: 0
Newey-West bandwidth selection using Bartlett kernel
Balanced observations for each test

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-2.00817	0.0223	4	48
Breitung t-stat	-1.48844	0.0683	4	44
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-2.01626	0.0219	4	48
ADF - Fisher Chi-square	16.9151	0.0310	4	48
PP - Fisher Chi-square	17.9416	0.0217	4	48
Null: No unit root (assumes common unit root process)				
Hadri Z-stat	1.94301	0.0260	4	52

** Probabilities for Fisher tests are computed using an asymptotic Chi-square distribution. All other tests assume asymptotic normality.

In conclusion, according to the model, can make the following ***remarks***:

- from the four factors, the one considered most important is freedom in business, followed by commercial freedom, monetary freedom and investment freedom;
- increase of freedoms of trade and investment leads to a compression of net FDI flows in the considered countries, which is attributed to market saturation (investment and commercial);

- increases in business and monetary freedoms boosting generates an increase in the net flow of foreign direct investment in the considered countries, which is explained by the existence of significant barriers in business development, and also in the price formation mechanism.

2.2 The importance of foreign participation in the privatization process

The privatization process has emerged as a real need in the transition process of countries of Central and Eastern Europe to a market economy, which differ from one country to another due to the start for the privatization process, sequence and scale. Adopted forms of privatization and restructuring of the ownership was strongly influenced by structures inherited from the old political system, degree of centralization, the policy of opening to foreign capital, skill level, ability to assimilate and interests of the public, the attitude of the international community.

Romania has gone through two stages of privatization, first privatization (MEBO and PPM) and the second privatization (direct sale). MEBO has not incurred substantial capital flows due to blockage of the sale of shares initiated by managers or reluctance of investors to invest in companies in which ownership was represented by employees. PPM has allowed the distribution of state assets through certificates of ownership, without delivering extra revenues from the central budget and without encouraging shareholders whose inactiveness was explained by wide dispersion of ownership. Direct sales, at prices negotiated with the government, allowed the accumulation of foreign currency resources to finance the current account deficit, but sometimes they have prevented other companies to invest in the post-privatization period due to the first investor-backed monopoly position.

Since 2002, there has been established a series of new measures aiming at privatization: the ability to sell less attractive shares at a symbolic price, debt restructuring through exemption from budgetary obligations, as well as continued implementation of the privatization contracts obligations. National strategies for privatization were replaced by individual strategies tailored to each company or group of companies and approved by the government (the major companies included in the PSAL I[6] and PSAL II[7] programs, or banking and insurance companies) (Moise, 2005:78).

In retrospect, we can say that the evolution after 1990 of the privatization process in Romania and hence the trend of foreign participation in restructuring, was placed under the influence of certain factors such as instability, deficiencies and lack of coherence in the legislation, temporary cancellation of facilities offered to investors,

[6] From 63 companies included in the Private Sector Structural Adjustment Program PSAL I, 54 have been privatized.
[7] From 20 companies included in PSAL II, 9 have been privatized.

government inability to manage arrears of companies with financial problems[8], reduced attractiveness of companies due to the financial blockage and burden, underdeveloped capital markets, frequent failures in partnerships between companies and private investors.

Hungary was, in the early 1990s, the most advanced country in Central and Eastern Europe in terms of progress towards the introduction of market economy and opening to the foreign investors. Direct sales were the primary method of privatization in Hungary, while MEBO and internal sales to other interested citizens ranked secondary. In particular, direct sales program took the form of auction sales (covering strategic partnerships) or public offerings and has proven to be transparent and accessible, ensuring equal opportunities for all investors.

Concerning the privatization in ***Hungary*** in general, several steps can be bounded time: *until 1994*, the State sold the most attractive companies in good condition and negotiable, offering, on a large scale assets to local investors; *since 1995 and until 1997*, privatization of strategic sectors belonging to large companies (public utilities, banks, companies of strategic importance) has been accelerated; *since 1997* capital market transactions and privatization of minor shareholdings have become the priority in the process of privatization; in recent years the government set the objective of completing the privatization (Resmini, 2004:27). At the moment we can say that privatization in Hungary, that started in 1990 by large-scale sales and in 1991 by small sales , is about to be terminated (the private sector in GDP reached 80% while at the beginning the process of restructuring the state sector represented more than 85% of the Hungarian economy) (Szany, 2008:118).

Although privatization regulation exists in ***Slovenia*** since 1992, developments in this respect were not significant, the private sector in GDP remaining low compared with other countries in the region. Access to the distribution of state assets to foreign investors is almost nonexistent, because the preferred methods of privatization are primarily MEBO programs and secondly, certificates of ownership. From a practical way, privatization in Slovenia has experienced two phases. The first phase (the privatization of social property) was officially completed on November 1st, 1998 when the completion of the privatization law was passed: 1381 companies were privatized, and the capital of 129 companies was transferred to the Slovenian Development Company. The second phase, ie the privatization of state-owned institutions, has been postponed (Simoneti / Gregory, 2008:22).

The sequence of privatization methods in ***Bulgaria*** is similar to that in Hungary, without FDI attracted in this way being of the same class: since 1993 direct sales took

[8] In the case of SIDEX Galați privatization in 2001, the state absorbed arrears of 1 billion dollars, while the public revenue due to privatization was of only 65 million dollars.

place at small and large scale, followed by the first delivery of certificates of ownership in 1996 and the second in 1999. By the end of 1998, 39% of the state assets were distributed through certificates of ownership or to other domestic investors, 6% to employees and only 1% to foreign investors. Here we also find the replacement of debt with equity participation (since 1994) and privatization through the stock market (since 1998), as methods of privatization. Since 2002, public offerings and auctions became the approved methods for the privatization process, while negotiations with potential purchasers were suppressed (Bandelj, 2007:54). In recent years, accelerating privatization was possible using the stock exchange mechanisms for public auctions without surveillance, centralized auctions and public offerings put on stand-by.

2.3 The presence of incentives to boost investment

In Romania, the main facilities (incentives) to investors can be grouped, generally, in the following categories: incentives for direct investment with significant impact in economy, incentives for investment in SMEs, incentives for investment in disadvantaged areas, incentives for investment in free zones, incentives for investment in industrial parks.

Facilities for direct investments with significant impact on the economy are given to those investments which exceed the equivalent of $ 1 million, made in any industry (except the financial sector, banking, insurance) and with a positive effect such as, modernized infrastructure and jobs creation, without prejudicing the interests of national security, environmental protection, etc. Facilities enjoyed by these investors, refer to: exemption from VAT payment for the import of industrial machinery, technological equipment, exemption from VAT payment for the import of raw materials and supplies, exemption from customs duties of imported equipment, the ability to recover tax losses from taxable profits in the next five years, etc...

Regarding *facilities for investment in SMEs*, these allow for tax losses to be recovered in an up to five years period, for priority access to assets of autonomous and state-owned companies, the use of accelerated amortization, priority access to public procurement of goods at a discount of up to 50%.

Incentives for investment in deprived areas provide exemption from income taxes for those investments made by legal persons who have obtained permanent investor certificate in a deprived area[9]. Certain restrictions are placed only on the scope of activities in which the investment is made, agriculture, forestry, logging, fishing, construction, trade, mining and industrial processing, etc.

[9] Deprived areas, 32 in Romania, are geographic areas strictly delimitated, constituted on a period of 3 to 10 years, that present an employment degree 3 times lower than the national average, or are either areas with underdeveloped infrastructure, or both.

Another category of facilities, *facilities for investment in industrial parks*[10] is reflected in the exemption from taxes for the change of destination or sealing of land for industrial parks, a deduction from taxable income for a share of 20% of the investment's value, for investment in the construction sector or rehabilitation of buildings, internal infrastructure and network connection to public utilities, exemption from taxes on land and buildings in industrial parks, tax reductions granted by the local authorities for immovable property transferable to the use of the industrial park.

Along with tax incentives investors may have access to other incentives such as free amounts for capital investments, granting of the land necessary for the investment at reduced prices as well as industrial facilities (infrastructure necessary for the investment project). The general trend is to give priority to these types of facilities at the expense of tax incentives (Marinescu, 2007:132).

In ***Bulgaria***, the Law on investment promotion, adopted in 2004, establishes four categories of preferential treatment for investments that meet the following criteria, namely: to result in the acquisition of assets in order to create new production capacities or expansion and modernization of existing ones, to be made in other areas than banking, insurance, investment funds, to help create new jobs and to be implemented within three years. Investment incentives differ among investment classes, set according to the value of the investment project, class 1 representing investments over 36 million EUR, class 2 investments between 20 and 36 million EUR and class 3 investments between 5 and 20 million EUR[11] (Hunya, 2006:31).

Currently, tax incentives, focus on: the possibility of applying accelerated depreciation for new equipment purchases under the new investment projects, tax credit for investment in disadvantaged areas[12], representing 10% of the investment value resulting from the acquisition, modernization or reconstruction of fix assets[13] and

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[10] The industrial park can be defined as an area in which take place economic activities, scientific research, industrial production and services, in a special facility regime, in order to value the human and material potential of the area.

[11] The advantage that all these investors have regards the shortening of time for the administrative procedures necessary for the investment plans. *Class 3* of investments can benefit only from information services: informational materials that precede implementation, information on potential partners, as well as information on administrative procedures for the project implementation. The beneficiaries of information are those in *Class 2* as well, which also have the possibility to authorize the Agency for the procurement, on the investor's behalf, of the necessary documents for the project implementation. *Class 1* investments are assisted by the Agency, not only through information and administrative services, but also through assistance in obtaining the property title on the buildings and support through supplying the necessary infrastructure.

[12] With an unemployment level that exceeds with 50% the national average...

[13] One can benefit of the fiscal credit for 5 years, meanwhile the acquired goods cannot be sold.

exemption from corporation tax (for a period of five years) for companies in the manufacturing sector, investing in disadvantaged areas[14] (UNCTAD, 2009:136).

One of the facilities in ***Hungary***, valid for ten years, may reduce the tax by up to 80% as investment tax credit. Criteria for granting such facilities take into account a minimum threshold of investment and its proper funding (25% own resources), appropriate destinations (at least 30% of new facilities or assets, and more than 20% restoration), but localization in strategic regions or investment orientation towards priority areas (environment, internet service, basic and applied research). Additional requirements are imposed on the recipient in the next five years: to increase the number of employees with at least 100 (or 50 in underdeveloped regions) or to increase labor costs at least 600 times the annual minimum wage (or 300 times in less developed regions) or to use SMEs as suppliers in a minimum of 30%. Another feature subject of SMEs taxable income is focused on reducing the amount of taxable profit with the value of the investment in assets, the deduction still being limited to the size of profit before tax and to the amount of 120.000 EUR. Deductible in calculating taxable profits are the investment loans, 40% and limited to 24.000 EUR per year (Hunya, 2007:41).

In the category of direct facilities, two are most important: the EU grants and special packages for strategic investors. Along with the European integration, Hungary had opened access to various grants offered by the Union, and subventions, focused on various development goals (business promotion, development of transports and human infrastructure,) can be obtained on request. Hungary's initiatives have resulted in the two National Development Plans, from which the second, which ensures access to EU funds of about HUF 7000 billion over seven years, is still under evaluation of the European Union [15] *(*Szanyi, 2008:123).

The incentives scheme offered to major strategic investors is tailored to their needs and provides a flexible and transparent framework for the subventions offered to big investors. Minimum investment threshold that determines access to the facility is differentiated between activities: EUR 50 million in the manufacturing sector and 10 million EUR in tourism, for the development of regional service centers for corporations, and research and development centers. Investor contribution is at least 40%. Projects must make an important contribution to the level of employment (100 new jobs for the manufacturing sector) and use recent technologies and equipment. Also important in evaluating the project are the following criteria: appeal to local suppliers, the technology

[14] The access to exoneration is conditioned by the investment of the fiscal credit in fixed assets, in a period of maximum 3 years from the date of the use of the credit.

[15] The following programs are beneficiaries of the EU grants: the one for economic competivity, rural and agricultural development, infrastructure and environment protection, labour and regional development.

and innovation level, the share of training costs, labor qualification, environmental impact and financial impact on the economy (OECD, 2008:128).

Giving incentives for investment, ***Slovenia*** has a pro-active policy both for investors who choose for the first time Slovenia as location, but also for those already engaged in operations here, to expand or improve production capacity. Investment incentives are grouped into three broad categories: fiscal, financial and other facilities.

Among the fiscal incentives there may be mentioned the profit tax rate decreased from 25% to 20% in 2010, and a series of reductions in the taxable base. This can be reduced with 20% of the size of investment in research and development equipment, with the loss brought forward in the next seven years, with 30% of the salary given to those who are at first employment (subject to offering a job for at least two years), with 50% or 70% of the wages given to those with various medical conditions, and redemptions resulting from linear method of depreciation, with established annual amortization rates (UNCTAD, 2009:162).

Financial facilities are the so-called grants scheme, introduced in 2000, in accordance with the national and European legislation on state aid to reduce market entry costs for the manufacturing industry and services, so as to increase competitiveness on international market. Facilities are available for investment in manufacturing industry and services (customer contact centers, distribution and logistics centers, regional headquarters) and research and development. Grants are subject to a minimum investment threshold (between 1 and 4 million), the minimum number of jobs created within 3 years (10-50), and the obligation to maintain premises for five years (Simonet/Gregory, 2008:26).

2.4 The role of foreign direct investment promotion agencies

Established relatively late, until 2002, the ***Romanian Agency for Foreign Investments***[16] (ARIS) is among the few existing agencies at an international level, who keep strictly as business object attraction of foreign direct investments. Subordinated to the government, it is entitled to impose its policy to attain economic growth and prosperity in Romania. Work done is not only a general improvement in the country's image to potential investors, but also a specific, well defined one.

[16] A first tentative for the creation of the institutional framework in the investment area has concretized in the Romanian Agency for Investment Promotion and Economic Assistance, which functioned for a relatively short period of time. Then, followed the Romanian Agency for Development, created to realize the government's agenda through attracting foreign capital. Despite numerous attempts to reorganize the RAD, it had not proven its efficiency in promoting foreign investments; therefore in 1999 its duties were taken over by the department for foreign investor relations of the Development and Forecast Ministry. Without result on investment flows, the promotions action passes as an attribution of the Romanian Agency for Foreign Investments.

Assistance to foreign investors in the implementation of projects, development and expansion, is a more technical one, embodied in providing information on legislation and on possible sites and industrial parks, mediation of contracts with local authorities, identifying potential partners (Moise, 2005:32). To align with the general trend of policy coordination, ARIS sets bilateral agreements with similar agencies in other countries[17].

In the last three years, in order to be prepared for changes to the completion of privatization and integration into the European Union (bringing restrictions in facilities granted to investors), the Romanian Agency for Foreign Investments has concentrated its efforts towards the implementation of pro –active policies, giving priority to Greenfield investments[18]. The actual strategy had focused on two directions: promoting Romania's image and providing specialty assistance, actual actions aiming at consulting the private sector and central and local authorities in devising strategies to promote foreign direct investment, promoting new and more attractive legislation to boost investment, positioning the Romanian Agency for Foreign Investment as a focal point of contact for potential or existing investors (Halmi, 2009:45).

An issue which should not be neglected in the present regards the fact that the relief to investors should be reconsidered in the context of regional competition, given that countries like Poland, Hungary, Czech Republic, Bulgaria offer conditions which exclude Romania from the competition for attracting direct investment. In addition, adherence to European structures and competition commitments prohibit Romania the granting of fiscal incentives, the only permitted incentives being the financial ones. The restrictions imposed by the EU, complemented by competition in the region, drives Romania to seek solutions to maintaining a legislative incentive for large foreign investment projects, which are still in line with European legislation.

The Bulgarian Investment Agency aims to facilitate the identification and implementation of Greenfield investment opportunities, for potential investors and those already existing in Bulgaria. The action carried out to promote investments in Bulgaria is facing the same lines as in Romania, but with a higher focus on highlighting the business sector opportunities and experiences resulting in success. Area presentation contains performance in the field, information about the market, competitive advantages, investment opportunities, and the situation of FDI in the sector, production, export activity, labour costs, and qualified labour in the field. Without attracting particular attention on the facilities available to investors (be they foreign or domestic), these are

[17] An example in this direction are the partnerships with Korea and China. Of importance is not only information availability for partners, on business environment and opportunities, but rather carrying out joint actions to promote foreign investment.

[18] In other words, as a prospect, ARIS no longer wishes to maintain an attitude of waiting and relying on privatization, but it attempts to identify the Romanian economy’s needs to directly address investors who can meet the.

presented in the law on investment that complements the legal framework, along with legislation on business environment and that specific to certain sectors (Denuța, 2005:63).

Created in 1993 under the Ministry of Economy and Transport, ***Trade and Investment Development Agency in Hungary***, has as main objective the establishment of relations between foreign business partners and local entrepreneurs, regional and central institutions. This is not merely to explore investment opportunities in Hungary for foreign firms, but seeks to identify opportunities for Hungarian companies, especially SMEs, to penetrate foreign markets either in a direct or indirect manner, seeking potential partners for them. Basic services provided, economic, legislative and market information is free, the rest being available at the customer's demand.

The investment promotion actions particularly aim at creating a single point of contact to support foreign investors in making investment decision in Hungary, to identify local suppliers and subcontractors (a special center was created to develop local supply network), management of regional projects, keeping updated databases on companies and business opportunities, publishing promotional materials, providing information relating the legislation, investment, taxation and finance of Hungary, advice on government programs to support investment decisions, supporting Greenfield investments, Brownfield or joint venture, advice in choosing the territory [19] (Halmi, 2009:47).

The Slovenian Public Agency for Entrepreneurship and foreign investments involves not only in technical assistance given to businessmen and investors, but also in financial assistance to improve economic competitiveness. Being created at the contact point between foreign importers, local exporters and investors, it has close links with central and local authorities but also with trade and professional associations. Services offered to foreign investors are free and include statistics on FDI, information on companies, industries, markets, business opportunities, operating conditions in some areas, site selection consulting, information for the development of investment strategies, achieving contact with authorities and clusters' suppliers (Szany, 2008:131).

3. TRAJECTORY OF THE INVESTMENT REFORM IN ROMANIA: WEAKNESSES VERSUS POSITIVE DEVELOPMENTS

In a retrospective view on the reform of foreign direct investment in Romania, we can say that a long period of time, the main weaknesses that have not allowed for developments and significant results are those that have targeted the governmental framework. Following the succession of tax laws from 1990, **there can be found some explanation for the low level of FDI attracted in Romania**. Not the absence of appropriate tax incentives scheme has attracted low investments (although temporary exemptions have not proven their efficiency, and other facilities were unsuccessful experiences), but the launch of large privatizations very late (1998) correlated with an unstable regulatory environment. In fact, there wasn't an overlap of the period with significant incentives granted with period of actual opening of the Romanian foreign investment flows.

Thus, in the early '90s, the small privatization offer, excluding public utilities and banks, did not allow to benefit from the stable and even attractive legal framework on FDI[20]. Later in the second half of the '90s and early 2000s, legislative and institutional framework, became extremely unstable, did not favour the participation of investors in the privatization process, then in growth[21]. Investors were cautious because of the economic downturn observed in this period (GDP fell by about 14%, domestic demand contracted public and private investment have been significantly reduced (UNCTAD, 2002:138)), so increases in FDI were not due essentially to new investments, but capital increases to existing investments. Failure to prepare a business plan in an unstable framework which does not allow medium and long term valuations on the profitability of investments in Romania, has directly discouraged investment.

Related to these weaknesses, we can say that in recent years, the **business environment** in Romania has seen **significant improvements**. Thus, prior consultation and transparency of procedures had turned into binding characteristics of the regulatory process, new communication channels are opened with the business community and society as a whole. In addition, the adoption of a comprehensive tax code and a medium-

[19] The whole investment promotion policy is carried around several prime domains that create consistent added value or that necessitate high level expertise: automotive, electronics, information technology, research and development, biotechnology, logistics.

[20] The law 35/1991 modified and supplemented by the law 57/1993 stipulated: exemption from customs duties for the contribution in nature of the foreign investor (raw materials, imported materials), a number of additional facilities for investment in areas of special interest, income tax reductions, and temporary exemptions from corporation tax. These regulations provided a fiscal framework for FDI quite well adapted to the transition that required providing incentives to foreign investors.

[21] In June 1997, urgency ordinance nr.31/1997 replaced Law nr.35/1991, with fewer incentives and only for large investors. Although stating that national treatment is ensured for foreign investors, access to facilities is conditioned by a minimum equity participation of 20% and not more than 350000 USD and a contract of sale of shares with SPF, valued at least one million dollars. Tax incentives are reduced, and national treatment gains. Urgency ordinance 92/1997 deletes the urgency ordinance no.31/1997 and kis modified by Law no. 241/1998. The new regulations expressly specify equal treatment - just and fair - for Romanian and foreign investors, resident or nonresident in Romania.

term fiscal strategy continuously contributes to ensure greater stability and predictability in business decisions.

A strength of the business environment is the application of nondiscriminatory treatment for foreign investments, meaning that foreign investors are allowed to invest in any field, whatever the legal form, may benefit from any existing incentives and income transfer obligation arising out of the investment. Other visible achievements in the field of synthetic investment policy can be viewed on the following lines: establishment of the Romanian Agency for Foreign Investment in 2002, and the creation of a national contact point, ongoing reform on investment policies that continue to cover Romania's transformation into a destination increasingly more attractive, and, not least, participation in global or regional programs of assistance in implementing reforms aimed at attracting investment and improving investment environment (the OECD investment in Southeast Europe[22], the OECD Declaration on international investment and multinational companies, European Charter for SMEs[23]).

A practical assessment of the state of the investment reform at the present time, as well as formulating proposals to improve any adverse developments can be achieved from interpreting the evolution of the ***Investment Reform Index (IRI).*** Designed to measure progress in investment reforms in the countries of Southeastern Europe, its role is to serve both state authorities to encourage reform and investors, by communicating position of a country as compared to other countries and international standard. Preliminary results on the state of the reform framework for investment in Romania, shows four areas where reform is most advanced (the competition policy, investment policy, trade policy and anticorruption) and four areas where reform is less advanced (fiscal policy, human capital, promotion of investment, regulatory reform) (OECD, 2010:310).

Regarding the *competition policy*, one can say that Romania has one of the most advanced competition policies in South - Eastern Europe, in line with international

[22] The Investment Agreement in South-Eastern Europe is an assistance program under the aegis of the OECD, aimed at improving the investment climate and encouraging private sector development in the signatory countries (Romania, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Montenegro, and Serbia). Essentially, the program supports countries in South - Eastern Europe, offering practical ways to increase investment for economic progress, aiming to implement a regional investment strategy for these countries to be able to compete in the global economy.

[23] The charter sets out ten policy dimensions in SMEs that should be enhanced to improve the business environment in which they work: education and training to start business, starting a business with lower cost and in less time, appropriate legislation and better regulation, the availability of skills, improving online access, greater benefits from the existence of the single market, fiscal and financing issues, technological capacity of SMEs, highlighting successful business models and developing a support system for SMEs, a better representation of SME’s interests at national and EU level.

standards, accounting substantial progress through the adoption of a coherent competition strategy for 2009-2010. Competition Council has undergone an administrative reform that aimed its budget and hiring appropriate personnel, and, in future, training of personnel required for the efficient administration of competition law and to exercise control in state aid, and also the rigorous application of sanctions for acts contrary to competitive behavior.

Regarding the *investment policy*, national treatment is guaranteed in most sectors by the investment law and by a proper implementation, including settlement of disputes between investors and state. Guarantees exist both for expropriation, and for unrestricted transfer of funds (profits and dividends). Well protected by law, intellectual property rights suffer from inadequate implementation through the lack of support and implementation. Individuals and foreign companies can buy buildings but not land during a transitional period.

Analyzed through the *trade policy*, Romania is relatively open to international trade, eliminating all quantitative restrictions. Free trade agreements are concluded with countries in South - Eastern Europe and the recent integration into the European Union fully liberalized trade within this area. However, the transparency of EU rules on veterinary and phytosanitary standards is not quite full. In addition, the average charges for industrial and agricultural products are still high (28% and 15% respectively). Special attention should be paid to VAT exemptions for imported capital goods for investment purposes. Improvements can still be made in customs administration, reducing the number of days to carry out import-export trade and the number of required documents.

Regarding *anti-corruption policy*, the Ministry of Justice has made significant efforts to ratify international conventions that criminalize acts of corruption (active and passive bribery, money laundering) and to adopt the Code on crime. Being placed on the same line, the fight against corruption in customs has resulted in developing a code of ethics for customs officials, which's strict and transparent implementation imposes appropriate training and effective application of sanctions. Finally it is recalled that an attempt was made to improve the public acquisition system through a strategy and action plan, although, it is equally important that they be supplemented by a rigorous implementation.

Regarding the *fiscal policy*, income tax rate is at a competitive level (16%), but the problem is what puts the overall tax burden for businesses. Although significant improvements have been made to the Tax Code, and tax strategy seeks to reconcile the various tax laws, there are still doubts about the stability of the tax system. The Fiscal Administration is posing the biggest problems, proving burdensome by frequent tax inspections, many requests for the preparation of acts, penalties based on unclear criteria. Added to this is the tense relationship between taxpayer and the Administration occasioned by errors that occur frequently in the taxpayer's fault, thus imposing a more serious assistance.

Regarding *human capital*, Romania adopted a coherent educational strategy for 2007-2010, with specific objectives and actions, in order to increase quality and employment level, but also care for adult education and vocational training to meet the needs market. Adult training programs initiated by the Ministry of Labour, focused mainly the sectors of construction, textiles, leather and electronics. It is required that skills development programs take into account the country's overall growth strategy, and the labour market to become even more flexible (flexibility in redundancy, training programs, promotions based on merit and not seniority).

Concerning the *promotion of investments*, there are recommendations for expanding the investment promotion strategy for 2007-2010 to include specific programs for priority sectors and encouraging foreign investment externalities to local businesses. The same strategy should be consistent with industrial policies and export encouragement. These developments would allow ARIS to develop marketing campaigns targeted on specific sectors. A special support should be given to Greenfield investors.

Finally, *regulatory/ stabilization reform* provides that annually, the Romanian government adopts action plans for improving the business environment, with specific targets. Regulatory quality has improved lately, especially due to consultations between public and private sectors, and long term strategies. Applied in areas such as competition policy and SMEs, regulatory impact assessments do not follow a rigid mechanism. The Legislative Council is the one that check the compliance of the legislative proposals with the Constitution and other fundamental laws.

4. CONCLUSIONS

In recent decades, globalization and liberalization processes, fundamental to the world economy, had put their print in the field of investment flows, the vast majority of countries introducing measures to liberalize the foreign direct investment framework. This fact offered multinational firms ever wider range of potential locations for investment and have made it more selective and demanding, a very important role being given to promoting policies to attract investors.

The orientation and typology of investment policies are conditioned, in a manner essential to the degree of development of the countries concerned. For the case of developing countries in the attempt to attract foreign investment and increase the benefits induced by them, there was usually preferred a market-friendly, but at the same time, prudent policy. As their market structures are more fragile and development requires more diligence, these countries are more concerned with preserving their national political space for investments that allow the use of tools adapted to their special needs.

Evaluation of investment policies on foreign direct investment for countries in Central and Eastern Europe since the 90s, allows formulating the following general understandings:

- ***Guarantees granted to investors*** cover the entire range of fundamental freedoms, the factors considered most important being freedom of business, followed in order of magnitude of impact by free trade, monetary and investment freedom.
- ***Development of the privatization process*** played an important role in attracting investment flows, the strategy being similar in all countries: we observe at the beginning of transition a preference for attractive companies selling, followed by the sale of large companies with difficulties and finally selling minority packages through the stock exchange. An important share of the companies remained in state ownership, either due to lack of interest from investors, or because of the state option for special treatment.
- ***The use of incentives***, namely tax relaxation schemes, has not proved unquestionably effective, which was shown by the absence of significant investment flows in the first decade of transition. Incentives designed to attract sustainable projects, facilitated short-term projects and the achievement of rapid benefits and facilities, while the benefiting activities were actually those that would have existed without them.
- ***Promotion agencies*** were created in all countries in order to give shape to an attractive environment for foreign investors. As a future perspective, the fact that globalization makes it increasingly difficult to delineate clearly between the two categories of investors, foreign and domestic, determines the agencies in question to extend their activity, hence the former agencies for promoting foreign investments tend to be converted into investment promotion agencies. In addition, interest is increasingly moving towards an organization and network of agencies with a significant representation at regional, local or international level.

For Romania, the process of reform in the field of foreign direct investment has had a tortuous journey from the beginning of the transition, with significant improvements in recent years. In the following period, it can strengthen its role for many multinational companies operating here, regional pole position being conferred mainly by its geographical position, as the EU border country, with opportunities opening up to the Caucasus, Central Asia and the Balkans. To maintain the interest of foreign investors, Romania has yet to improve factors economic performance that are likely to become more attractive to FDI and improve the political factor. Before taking up an active policy of attracting FDI, efforts are needed to ensure the multiplication of their benefits for the economy and increase local capacity to absorb the externalities brought by foreign companies.

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